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Stumbling Forward on Trade: The Doha Round, Free Trade Agreements, and Canada

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- With multilateral trade negotiations under the Doha Round in disarray, Canada has joined the rush to sign free trade agreements (FTAs) with partners around the globe.
- However, the decision to pursue FTAs should not be made lightly, because FTAs may have the tendency to lessen tariff reductions in multilateral trade negotiations.
- While FTAs are a backup plan, Ottawa should put a priority on a successful outcome for the Doha Round.

In recent years, the world has seen a proliferation of free trade agreements (FTAs) and, with the Doha Round on the rocks, the trend will likely continue.[1] The flurry of newly ratified and potential US FTAs, notably with Australia and Korea, has been particularly worrisome for Canadians. Fears that Canada's importance in US trade could dwindle, relegating Canada to a spoke on a US trading hub – a sentiment which helped bring about the Canada–US FTA and ultimately NAFTA – have re-emerged (Wonnacott 1990). These fears have brought calls to deepen North American integration (Robson 2007, Dymond and Hart 2008) and – the focus of this study – to expand Canada's roster of FTA partners (Standing Committee on International Trade 2007).[2] Indeed, in the past year, Canada's federal government has initiated or negotiated trade agreements with numerous countries, including Colombia, Peru, and Korea and, most recently, the European Union.

But before continuing headlong into the FTA game, Ottawa should pause to consider the effects of creating a web of FTAs. The decision to pursue FTAs should not be made lightly, because FTAs have the tendency to interfere with multilateral trade negotiations that potentially would deliver broader benefits (Limão 2006, Karacaovali and Limão 2008 and Adler 2007).

How do they interfere? Countries' interests may shift away from global trade toward regional FTAs (Bhagwati 1991, 2008). The benefit a country derives from an FTA may cause it to approach multilateral trade negotiations with more

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1 By 2006, 350 FTAs had been reported to the WTO, up from 124 in 1994 (WTO 2007).

2 Alexandroff, Hufbauer, and Lucenti (2008), outline the benefits of a fresh, primarily bilateral approach to NAFTA for Canada and the US.

reluctance to liberalize than before.[3] In FTA negotiations, these countries may find themselves pursuing non-trade objectives (Limão 2007), buckling to lobbying power (Krishna 1998), or focusing on foreign policy rather than economic goals.[4] And with low bilateral trade barriers, an FTA may create closer ties between partners, not a bad thing when, for example, security is an issue. But trade barriers have relative importance; low tariffs (and other barriers) make the biggest impact on a bilateral relationship when barriers to other countries are relatively high.[5] So countries wanting to preserve their non-trade benefits in FTAs will keep barriers to the rest of the world high relative to their FTA barriers.

To examine the impact of FTAs on multilateral trade, Limão (2006) and Karacaovali and Limão (2008) compared Uruguay Round tariff reductions for goods covered by FTAs with Uruguay Round reductions for goods not included in FTAs.[6] If reductions on non-FTA goods were statistically larger than those on FTA-included goods, it would suggest FTAs hindered the Uruguay Round of multilateral trade negotiations – in other words, FTAs were stumbling blocks to freer global trade.[7]

Following from this method, the United States' FTAs caused the United States to liberalize less than they otherwise would have during the Uruguay Round. Limão (2006) found that the mean tariff reduction on goods included in FTAs was 2.8 percent, compared to 4.0 percent for non-FTA goods. Hence, US tariff cuts during the Uruguay Round on FTA-covered goods would have been about 1.3 percent larger had no US FTAs been in place, thereby making the Round harder to complete because the package on the table was less attractive.[8]

Similarly, Karacaovali and Limão (2008) found that the EU mean tariff reduction was 2.9 percentage points for goods included in FTAs and 4.4 percentage points for non-FTA goods. Moreover, the authors' econometric work shows that EU tariff cuts on FTA-included goods would have been approximately 1.5 percentage points larger had no EU FTAs been in place. My own econometric work, which follows from Limão (2006) and Karacaovali and Limão (2008), suggests that Canadian tariff reductions during the Uruguay Round on goods included in NAFTA would have been approximately 1.0 percentage point larger had NAFTA not been in effect (Adler 2007).[9]

Implications

Canada is a founding member of the GATT and the WTO, and has long been committed to the success of the multilateral trading system. With grim prospects for Doha, FTAs appear to be an attractive backup plan. But the findings I raise here complicate matters. FTAs cannot be enacted without running the risk that they will make the Doha Round harder to complete. So if Canada truly values the multilateral trading system, Ottawa's leadership should put a priority on a successful outcome for the Doha Round.

This does not imply that Canada should immediately abandon plans for further FTAs. While statistically significant, the impact of US, EU, and Canadian FTAs on the Uruguay Round was small relative to each country's overall tariff cuts. Moreover, the Uruguay Round was ultimately completed. The countries were able to derive benefits from their FTAs and a complete multilateral trade

3 The title of this *e-brief* alludes to a term coined by Bhagwati (1991). He calls FTAs "stumbling blocks" if they hinder multilateral trade negotiations and "building blocks" if they help. For a review of this field see Panagariya (2000). Limão (2006) provides an update.

4 A likely example is the US-Israel FTA.

5 For example, a zero tariff between two countries will have a much bigger impact if those countries' tariffs to the rest of the world are 50 percent rather than 5 percent.

6 To be sure, the second set of goods is usually smaller than the first.

7 Baldwin and Seghezza (2008) provide an alternative method for investigating the impact of FTAs on multilateral trade negotiations. They find no indication that FTAs hinder multilateral trade negotiations.

8 The 1.3 percent figure comes from the author's econometric analysis; it does not follow directly from a comparison of the mean tariff reductions.

9 This effect may seem quite small, but as a share of the average Canadian Uruguay Round Tariff reduction (5.8 percent) it is more than 15 percent of Canadian tariff cuts.

round. Canada, in particular, was able to foster closer ties with the United States,[10] and gain from the Uruguay Round, although, as evidence indicates, the gains from the Round were smaller than otherwise would have been the case.

Even without any FTAs, however, there is little assurance that Doha can yet be completed. The disagreements on sensitive issues like agriculture and the many other issues complicating the success of the Round would still be at play. So for any country, including Canada, it may be rational to engage in FTAs despite their negative impact on Doha, because the benefits of the Round may never come.[11] Consequently, in its decision to engage in FTAs, Canada must weigh the cost of adding to the witches' brew that already plagues the Doha Round, against the cost of sitting alone on the sidelines of the FTA game, hoping that the Round is completed. However, Canada, with its history of engagement in the GATT and WTO and relative importance in the world economy may be uniquely placed to provide leadership on the issues hindering the Round. A bold show of support out of Ottawa may go a long way to helping the struggling Doha Round succeed.

10 For some results on the productivity benefits of NAFTA see Trefler (2004). For an alternative result that finds no welfare benefits from NAFTA, see Romalis (2007). Romalis additionally conjectures that NAFTA may have made multilateral trade liberalization more difficult since it increased trade volumes to a greater degree in sectors that were highly protected.

11 Alternatively, a completed Doha Round could be so watered down that it would be virtually meaningless.

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